

Notice

CC-2009-016

May 27, 2009

Subject: Procedures for Evaluating and
Responding to Qualified Offers
Submitted Under Section 7430(g) **Cancel Date:** Upon incorporation
into the CCDM

Purpose

This Notice updates the procedures to be followed when a taxpayer provides the Internal Revenue Service with a settlement offer that purports to satisfy the qualified offer rule of I.R.C. § 7430. Revised procedures are necessary to ensure purported qualified offers are reviewed appropriately and handled consistently.

Background

Under the qualified offer rule, a taxpayer who meets the net worth requirements and has exhausted his administrative remedies may recover reasonable administrative and litigation costs from the Service if the taxpayer's liability pursuant to a judgment in a court proceeding is equal to or less than the liability the taxpayer would have incurred if the Service had accepted the taxpayer's qualified offer. Section 7430(c)(4)(E). One effect of the qualified offer rule is to eliminate the Service's defense that its position was substantially justified. Section 7430(c)(4). Costs can include fees for the services of an attorney. Section 7430(c)(1)(B)(iii) and (2)(B).

To receive the benefit of the qualified offer rule, the taxpayer must submit a written offer meeting five statutory requirements. First, the written offer must state that it is a qualified offer. Section 7430(g)(1)(C). Second, the offer must be made to the United States, as defined in Treas. Reg. § 301.7430-7(c)(2). Section 7430(g)(1)(A). Third, the offer must be made during the qualified offer period. Section 7430(g)(1)(A). Fourth, the offer must remain open for the statutory period, namely, from the date the offer is made until the earlier of the date it is rejected in writing by the Service, the date trial begins, or the 90th day after receipt by the United States.¹ Section 7430(g)(1)(D). Fifth, the offer must specify the offered amount of the taxpayer's liability determined without regard to interest. Section 7430(g)(1)(B).

¹ If no period is specified, the Service will presume the offer is open for the statutory period. The taxpayer may extend the period the offer is open before it expires. However, an offer that states it is open until withdrawn by the taxpayer will not be considered open for the statutory period. See Treas. Reg. § 301.7430-7(c)(5).

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Certain issues recur frequently in evaluating whether offers are qualified offers. One is whether the offer was made during the qualified offer period. The qualified offer period begins with the date of the first letter of proposed deficiency that allows the taxpayer an opportunity for review in Appeals and it ends thirty days before the date the case is first set for trial. Section 7430(g)(2). The qualified offer period will be extended if the case is removed from the trial calendar more than thirty days prior to the calendar call. Treas. Reg. § 301.7430-7(c)(7). In those cases, the qualified offer period does not end until the case remains on a trial calendar on the date that precedes by thirty days the scheduled date of the calendar call for that trial session. Treas. Reg. § 301.7430-7(c)(7). For example, if a case is first scheduled for trial on May 1, the qualified offer period will end on April 1. If the case is continued on March 31 until July 1, then the end of the qualified offer period will be extended until June 1. If the case had been continued on April 1 until July 1, the qualified offer period would not be extended and would end on April 1.

A second frequently recurring issue is whether an offer is made without regard to interest. The Code states that qualified offers must specify “the offered amount of the taxpayer’s liability (determined without regard to interest).”² Section 7430(g)(1)(B). An offer does not need to state that it is “without regard to interest.”³ The regulation clarifies that interest may only be included in the offer if interest “is a contested issue in the proceeding.” Treas. Reg. § 301.7430-7(c)(3). Generally, interest is considered a contested issue only if the interest is specifically at issue in the proceeding independent of the taxpayer’s objections to the underlying tax imposed. Moreover, before interest can be at issue, the court in which the proceeding has been brought must have jurisdiction to determine the amount of interest due on the underlying tax, penalties, additions to tax and additional amounts, which is relatively rare.⁴ For administrative proceedings prior to the commencement of a court proceeding, interest will only be considered at issue if the Tax Court would have jurisdiction over interest once the taxpayer receives a statutory notice and files a petition. Unless and until a taxpayer full-pays the interest, no taxpayer may assert that interest is at issue because the District Court could exercise jurisdiction over interest in a refund case. If the court would not have jurisdiction over interest, it cannot be a contested issue in the proceeding.

² Section 7430(c)(3)(E) allows the court to award fees if the liability of the taxpayer pursuant to the judgment of the court is equal to or less than the amount that the liability of the taxpayer would have been if the United States had accepted the qualified offer. For jurisdictional reasons explained below, the court will generally enter its judgment without regard to interest. If an offer is made including interest, it will be significantly more difficult to compare the offered amount with the judgment amount.

³ Examples of compliant language include “Taxpayer offers \$X in satisfaction of the tax liability and \$Y in satisfaction of the penalty for tax year Z;” or “Taxpayer offers to concede X% of the tax liability and Y% of the penalty for tax year Z.”

⁴ For an extensive discussion of the limitations of the Tax Court’s jurisdiction with respect to interest, particularly within settlements, refer to Smith v. Commissioner, T.C. Memo. 2009-33. In the Smith case, the Tax Court explained that “[e]ven if the parties in a deficiency case unanimously requested it, the Court would not purport to enter a decision awarding or denying deficiency interest to the Commissioner.” Examples of cases in the Tax Court in which interest could be a contested issue are interest abatement cases under section 6404 and transferee liability cases. The statutory notice should specify if interest has been assessed, indicating that the Tax Court would have jurisdiction over interest. In contrast, the District Court generally will have jurisdiction over interest in a refund case. See Commissioner v. McCoy, 484 U.S. 3 (1987).

A third frequently recurring issue is whether a taxpayer is eligible to receive fees if the qualified offer is accepted or if the offer is determined not to be a qualified offer. The qualified offer rule is intended to encourage settlement. Therefore, if the taxpayer makes a qualified offer and the Service settles the matter, either by accepting the offer or by other means, the qualified offer rule does not provide for an award of fees. However, a taxpayer who settles a matter or makes an offer that is not a qualified offer may still be able to obtain costs under the general provisions of section 7430. Under those provisions, to recover costs the taxpayer must prove that he substantially prevailed as to the amount in controversy or with respect to the most significant issue or set of issues presented. Furthermore, the Service will not be liable for costs under section 7430 if it establishes that its position was substantially justified.

Procedure

Upon receipt of a settlement offer that purports to be a qualified offer, field counsel should promptly notify Procedure and Administration Branch 5 by faxing a copy to Branch 5 at (202) 622-8882. A copy of the purported qualified offer and any relevant documentation, including a copy of the statutory notice and taxpayer's petition should also be forwarded to Branch 5 through TSS4510. At the time that the documentation is sent to the National Office, Field counsel should inform Branch 5 whether the case is on a trial calendar or has otherwise been set for trial, and if so, the date of the calendar call or trial. Branch 5 will review the purported qualified offer promptly and determine whether it meets the requirements of sections 7430(c)(4)(E) and (g). The review will include a determination as to whether the offer should be treated as a qualified offer, and generally, will not include a recommendation as to whether the offer should be accepted. Branch 5 will convey the determination to the field in a timely manner, mindful of allowing adequate time for the field to effectuate the acceptance or rejection of the offer. If a valid qualified offer is to be accepted, a written response should be prepared and sent. (Sample letters accepting and rejecting a valid qualified offer are attached as Exhibits A and B.) If it is determined that the offer is not a valid qualified offer, a written response should be prepared and sent either accepting the offer on its merits as a regular settlement offer or rejecting the offer on its merits. (Sample letters accepting and rejecting an offer that is not a valid qualified offer are attached as Exhibits C and D.) If it is determined that a valid qualified offer should be rejected on the merits, then, on a case-by-case basis, either a written response should be sent or the offer should be allowed to lapse.

All written responses should be submitted to Procedure and Administration Branch 5 through TSS4510 for review before they are sent to the petitioner(s)' representative. A copy should also be e-mailed directly to the Branch 5 attorney who reviewed the offer, or if one cannot be identified, the Branch Chief. Branch 5 will complete the review promptly, mindful of allowing adequate time for the field to complete its task.

All written responses should include the following:

- State if the offer is a valid qualified offer.
- State whether the Service will accept or reject the offer.
- Describe briefly the Service's understanding of the terms of the offer.
- If the offer is not a qualified offer, explain why that is so, and (if the offer is not accepted) how the offer could be revised to constitute a qualified offer.
- Affirmatively request that, if the Service has misconstrued the offer, petitioner's representative reply in writing explaining the misunderstanding regarding the offer.

Sample written responses are attached to guide field counsel in drafting these letters.

Any questions regarding this Notice should be addressed to Procedure and Administration Branch 5 at (202)622-3620.

/s/
Deborah A. Butler
Associate Chief Counsel
(Procedure and Administration)

Exhibit A — Accepting a valid qualified offer

Exhibit B — Rejecting a valid qualified offer

Exhibit C — Accepting an offer that is not a qualified offer because it was not timely made

Exhibit D — Rejecting an offer that is not a qualified offer because it includes interest

Exhibit A — Accepting a valid qualified offer.⁵

Dear **[insert petitioner(s)' representative's name]**:

This letter is in reference to your qualified offer dated **[insert date of letter]**. We are prepared to accept the offer, which we understand to be an agreement to a deficiency of **[insert dollar amount]** for **[insert tax year]**, in addition to **[insert penalty amount]** in penalties. Interest will be assessed as provided by law.

In order to finalize our settlement, we must file with the Tax Court a decision document that shows the amount of tax and additions to tax/penalties that petitioner(s) owe based on that settlement.

Enclosed are the following documents:

1. A decision document (original and two copies) that shows the amount that petitioner(s) owe;
2. A Statement of Account that shows the calculation of the amount owed and all the payments and other credits that are reflected on the records of the Internal Revenue Service for the tax year(s) at issue in this case;
3. A calculation of the estimated interest that petitioner(s) owe based on the settlement if petitioner(s) pay the entire amount of tax [additions to tax/penalties] and interest by [date]; and
4. Publication 594, which explains the collection process.

Please carefully review the Statement of Account, the interest computations and the decision document to make sure that you agree with them. It is important that they be correct because the United States Tax Court will usually not change its decision, even if there is a mistake, unless the court is notified of the mistake within 30 days after the decision is entered by the court. If you believe that there are mistakes in our calculations of the amount petitioner(s) owe or in the decision document, please telephone me as soon as possible.

If you agree with the calculations and the decision document, please sign the original and one copy of the decision document and return them to this office for filing with the Tax Court. The remaining copy, as well as the Statement of Account and the calculation of interest, are for your records. [The United States Tax Court has ordered the parties to file the decision document by [date decision document due with court], so you should return the decision document to me before that date so that we can file it with the court on time.]

Once the decision document is filed and entered by the Tax Court, the Internal Revenue Service will send petitioner(s) a bill for the amount he/she/they owe. [Because a joint return was filed, both spouses are jointly and severally liable for the tax, any additions to tax and penalties and the interest.] In case petitioner(s) want to pay the tax, [additions to tax/penalties] and interest before he/she/they receive the bill, petitioner(s) may do so. As previously noted, the interest calculations are estimates and only apply until [dates noted above]. A final computation will be made at the Service Center. The interest petitioner(s) owe will increase if full payment is not made by those dates. Also, interest will continue to run on the unpaid portions if petitioner(s) pay less than the total amount due. If petitioner(s) decide to immediately pay some

⁵ If statements of account or interest computations are not available the language of the letter may be modified appropriately.

or all of the amount he/she/they owe, petitioner(s) should mail a check to the [name and address of local Service Center]. The check should be made payable to the United States Treasury. In order to process the check and apply the payments appropriately, petitioner(s) should include all of the following information with the check:

1. Petitioner(s) name(s) and address(es).
2. Petitioner(s) Social Security number(s).
3. The tax year(s) for which payment is being made.
4. The type of tax due (for example, income tax, estate tax, excise tax).
5. The total amount of petitioner(s) payment. If petitioner(s) owe tax for more than one year, the Internal Revenue Service will also need to know how much he/she/they are paying for each year. Petitioner(s) should also state how much of each year's payment he/she/they are paying towards tax, [how much for the additions to tax,] and how much towards interest.
6. A copy of the decision document that you have signed.

Please be advised that you should not consider any agreement to settle this case final and binding until we have executed the decision document and mailed it to the Tax Court for filing.

If you have any questions, please contact me at telephone number **[insert telephone number]**. If you believe we have misconstrued your offer, please respond in writing explaining the misunderstanding.

Sincerely,

Senior Attorney
(Small Business/Self-Employed)
T.C. Bar No.

Exhibit B — Rejecting a valid qualified offer.

Dear **[insert petitioner(s)' representative's name]**:

This letter is in reference to your qualified offer dated **[insert date of letter]**. We understand your offer to be an agreement to a deficiency of **[insert dollar amount]** for **[insert tax year]**, in addition to **[insert penalty amount]** in penalties. We do not find these terms to be an acceptable settlement and reject your qualified offer.

If you wish to submit a new settlement offer or if you believe that we have misconstrued your offer, please respond in writing.

Sincerely,

Senior Attorney
(Small Business/Self-Employed)
T.C. Bar No.

Exhibit C — Accepting an offer that is not a qualified offer because it was not timely made.⁶

Dear **[insert petitioner(s)' representative's name]**:

This letter is in reference to your offer dated **[insert date of letter]**. The offer does not meet the requirements of a qualified offer because it was not timely made during the qualified offer period as described in I.R.C. § 7430(g) and Treas. Reg. § 301.7430-7(c)(7). Pursuant to section 7430(g), a qualified offer must be submitted to the United States during the qualified offer period, which ends “on the date which is 30 days before the date the case is first set for trial.” This case was first set for trial on **[insert trial date]** by court order dated **[insert order date]**. Therefore, the qualified offer period ended on **[insert date 30 days before trial date]**. Because your offer was submitted after that date, it is not a valid qualified offer under the statute.

Nevertheless, we have reviewed your offer as a standard offer for settlement. We are prepared to accept your offer, which we understand to be an agreement to a deficiency of **[insert dollar amount]** for **[insert tax year]**, in addition to **[insert penalty amount]** in penalties. Interest will be assessed as provided by law.

In order to finalize our settlement, we must file with the Tax Court a decision document that shows the amount of tax and additions to tax/penalties that petitioner(s) owe based on that settlement.

Enclosed are the following documents:

1. A decision document (original and two copies) that shows the amount that petitioner(s) owe;
2. A Statement of Account that shows the calculation of the amount owed and all the payments and other credits that are reflected on the records of the Internal Revenue Service for the tax year(s) at issue in this case;
3. A calculation of the estimated interest that petitioner(s) owe based on the settlement if petitioner(s) pay the entire amount of tax [additions to tax/penalties] and interest by [date]; and
4. Publication 594, which explains the collection process.

Please carefully review the Statement of Account, the interest computations and the decision document to make sure that you agree with them. It is important that they be correct because the United States Tax Court will usually not change its decision, even if there is a mistake, unless the court is notified of the mistake within 30 days after the decision is entered by the court. If you believe that there are mistakes in our calculations of the amount petitioner(s) owe or in the decision document, please telephone me as soon as possible.

If you agree with the calculations and the decision document, please sign the original and one copy of the decision document and return them to this office for filing with the Tax Court. The remaining copy, as well as the Statement of Account and the calculation of interest,

⁶ If statements of account or interest computations are not available the language of the letter may be modified appropriately.

are for your records. [The United States Tax Court has ordered the parties to file the decision document by [date decision document due with court], so you should return the decision document to me before that date so that we can file it with the court on time.]

Once the decision document is filed and entered by the Tax Court, the Internal Revenue Service will send petitioner(s) a bill for the amount he/she/they owe. [Because a joint return was filed, both spouses are jointly and severally liable for the tax, any additions to tax and penalties and the interest.] In case petitioner(s) want to pay the tax, [additions to tax/penalties] and interest before he/she/they receive the bill, petitioner(s) may do so. As previously noted, the interest calculations are estimates and only apply until [dates noted above]. A final computation will be made at the Service Center. The interest petitioner(s) owe will increase if full payment is not made by those dates. Also, interest will continue to run on the unpaid portions if petitioner(s) pay less than the total amount due. If petitioner(s) decide to immediately pay some or all of the amount he/she/they owe, petitioner(s) should mail a check to the [name and address of local Service Center]. The check should be made payable to the United States Treasury. In order to process the check and apply the payments appropriately, petitioner(s) should include all of the following information with the check:

1. Petitioner(s) name(s) and address(es).
2. Petitioner(s) Social Security number(s).
3. The tax year(s) for which payment is being made.
4. The type of tax due (for example, income tax, estate tax, excise tax).
5. The total amount of petitioner(s) payment. If petitioner(s) owe tax for more than one year, the Internal Revenue Service will also need to know how much petitioner(s) are paying for each year. Petitioner(s) should also state how much of each year's payment he/she/they are paying towards tax, [how much for the additions to tax,] and how much towards interest.
6. A copy of the decision document that you have signed.

Please be advised that you should not consider any agreement to settle this case final and binding until we have executed the decision document and mailed it to the Tax Court for filing.

If you have any questions, please contact me at telephone number **[insert telephone number]**. If you believe we have misconstrued your offer, please respond in writing explaining the misunderstanding.

Sincerely,

Senior Attorney
(Small Business/Self-Employed)
T.C. Bar No.

Exhibit D — Rejecting an offer that is not a qualified offer because it includes interest.

Dear **[insert petitioner's representative's name]**:

This letter is in reference to your offer dated **[insert date of letter]**. We have concluded that the offer does not meet the qualified offer requirements contained in I.R.C. § 7430 and the corresponding regulations and is, therefore, not a valid qualified offer.

The offer states that petitioner(s) agree to pay **[insert dollar amount]** to settle the petitioner(s)'s tax liability, including penalties and interest. Pursuant to section 7430(g)(1)(B) and Treas. Reg. §§ 301.7430-7(c)(1)(ii) and (3), the offered amount must be determined without regard to interest, unless interest is a contested issue in the case.

Generally, interest can be a contested issue only if the court in which the proceeding was brought has jurisdiction to determine the amount of interest due on the underlying tax, penalties, additions to tax and additional amounts. The Tax Court is a court of limited jurisdiction and it may exercise its jurisdiction only to the extent authorized by Congress. Naftel v. Commissioner, 85 T.C. 527, 529 (1985). The Tax Court does not have jurisdiction to decide questions related to interest in a deficiency case. Commissioner v. McCoy, 484 U.S. 3 (1987). See also Smith v. Commissioner, T.C. Memo. 2009-33. Thus, the Tax Court does not have jurisdiction over the interest in this case. Because the Tax Court lacks jurisdiction over interest in this case, interest cannot be a contested issue under these facts. Therefore, the inclusion of interest in the offered amount violates the rules of section 7430(g).

Pursuant to section 7430(g)(2)(B) and Treas. Reg. § 301.7430-7(c)(7), the qualified offer period ends 30 days prior to the date the case is first calendared for trial. The qualified offer period is still open. You may submit a new offer that complies with section 7430(g) and the corresponding regulations during the qualified offer period. If you have any questions, please contact me at telephone number **[insert telephone number]**. If you believe we have misconstrued your offer, please respond in writing explaining the misunderstanding.

Sincerely,

Senior Attorney
(Small Business/Self-Employed)
T.C. Bar No.